

MEMORANDUM

THE WHITE HOUSE
WASHINGTON

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MEMORANDUM FOR THE PRESIDENT

FROM: Henry A. Kissinger

SUBJECT: FY 1971 AID Program Loan for Pakistan

State (Tab A) recommends that you approve a \$100 million FY 1971 AID program loan to Pakistan and be the first to inform President Yahya when you see him on October 25.

Background

Under Yahya, Pakistan has performed well economically in the face of severe droughts, decreasing foreign aid, and serious political problems. However, a complicated foreign exchange system has resulted in extensive controls on trade and investment which have led to under-utilized industrial capacity and inefficiency in the industrial sector. Pakistan, consulting with the IMF and World Bank, has now decided to reform its foreign exchange system to provide for greater reliance on market forces to determine the allocation of scarce foreign exchange. This should increase the use of existing plant capacity and improve the efficiency of the industrial sector.

This has not been an easy decision for President Yahya to make. He had initially felt he had to postpone it until after elections, which were originally scheduled for September. Despite postponement of the elections until December, he has apparently decided to go ahead with the devaluation next month if details can be worked out.

Details of the reform are still being negotiated with the IMF, which has tentatively agreed to provide a standby agreement of \$125 million. These funds would be used in support of Pakistan's currency during the initial stages of the reform when reserves may be drawn down by the initial surge in demand for imports under the liberalized scheme, and confidence in Pakistan's currency may be low. The United Kingdom and Canada have indicated they would provide additional program loans in order to supply Pakistan with additional foreign exchange for the same purpose.

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Given U.S. budgetary restraints and the probability that some aid funds will have to be re-allocated to Cambodia, State proposes a program loan of \$100 million (last year's program loan was \$103 million, plus a \$13 million project loan.) Had the exchange reform not materialized, AID would have recommended \$80 million for Pakistan to be provided next February or March, after the Congressional appropriation was passed and apportioned. To support the exchange reform, however, AID has (1) added \$20 million and (2) proposed commitment of the full \$100 million now as an indication of support for Yahya in a difficult move just before elections and as an inducement to other consortium members to follow suit.

Although we would be pledging funds before the AID appropriation was passed, this would be possible under continuing resolution authority. There is some risk in committing funds before we learn the appropriation figure and before we can take into account the amount which will be needed for Cambodia. If the appropriation figure were lower than expected, or contingencies higher, we might have to significantly cut other programs. However, Yahya's reform is of such potential economic significance in Pakistan that there is general agreement that the risk is manageable for this purpose.

If you approve this loan, you might indicate to Yahya, at your meeting with him on Sunday, that we are pleased that Pakistan appears to be on the verge of success in working out an effective exchange reform program and that -- assuming successful completion of negotiations with the IMF, the World Bank and the Consortium -- the United States will support it by signing a \$100 million FY-71 AID program loan at that time, several months earlier than we would normally do so.

A more cautious approach would be to provide an initial tranche of \$50 million, leaving the full year's total to be decided later. This, however, might be regarded by Pakistan as lack of support for their reform program which we have long advocated.

RECOMMENDATION

That you approve State's recommendation of a \$100 million FY-71 AID program loan to Pakistan, assuming successful completion of the reform negotiations. (Treasury, OMB -- Tab B -- and Bill Timmons concur.)

Approve *K for Rd*

Disapprove, prefer that we provide an initial tranche of \$50 million, leaving the full year's total to be decided later. _____

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